THE WORK OF THE PROMOTER

Every week of the year deposits of minerals are discovered, franchises are obtained, patents are granted. Railway extensions are constantly bringing land, timber and coal into the market—increasing population offers a basis for water, light and transportation plants. New inventions stimulate new wants and these wants in their turn produce new means of satisfaction. The field for investment, either in new enterprises, or in the extension and diversification of established industries is infinitely various. To take but one field, the production of power, we find a vast range of opportunity for profitable investment. We have first of all the mechanical draft and the mechanical stoke, the use of superheated steam to reduce condensation, the inside firing boiler to prevent radiation through the fire-box, the steam turbine to utilize the direct pressure of steam, and the various devices which purify the water before it goes into the boiler, and to cleanse it for future use by condensing the exhaust steam. In other divisions of the field of power we have the development of electrical power transmission, which is bringing into the field of investment a large number of water powers which until recently were worthless and wasted, and we have the general introduction of the gas engine which promises not only to solve the question of the small power plant, but to double the efficiency of coal by using it in two forms, coke and gas. In other fields similar opportunities are multiplying. Improvements long since discovered are forcing themselves into general notice. New improvements are attracting instant attention. Never before in the world's industrial history has man increased his conquest over nature at such a rapid rate and simultaneously in so many fields.

These opportunities for production of wealth are opportunities for the investment of money, since the investment of money is in the vast majority of cases, either directly or indirectly the production of wealth. The investor buys $50,000 of railway bonds. With the proceeds the railroad replaces a wooden trestle with a steel bridge. Over this bridge it can run a heavier train load which it obtains by the lower rate, which the decrease in operating cost resulting from that heavier train load makes possible. The lower

rate enables the farmer to turn a part of his grazing land into wheat, and so eventually and indirectly the $50,000 which was invested in the railway bonds has increased the supply of wheat on the world's market. This increased production of wealth, therefore, was made possible by the purchase of the bonds which the investor bought, because of its increased earnings the railroad could pay him 4 per cent. Without the investment of money increased production would be impossible. Upon the investor rests the responsibility of increasing the wealth of the world. As he directs his funds, this way or that, to railroads, cotton mills, irrigation or ship-building, the productive energy of society is exerted in this or that field of enterprise.

Two Classes of Investors

This office of investment is variously performed. Men may invest or capitalize their own savings. The farmer devotes $1,000, half the proceeds of his last wheat crop, to the purchase of nitrate fertilizer. The New England cotton manufacturer invests his surplus earnings in a South Carolina mill where cheap power, labor and material invite development. The Bessemer steel maker adds an open hearth furnace to his equipment and takes advantage of a large supply of scrap iron. The Pennsylvania coal operator or lumberman buys the cheap coal and timber land of the South. Every producer is continually devoting his surplus funds to enlarge his enterprise along lines with which he is familiar as the opportunity presents for greater profits or as competition forces. He may occasionally branch out into other fields, as when the farmers of a locality erect a flour mill or saw mill or open a stone quarry, or where the carriage-maker goes into the manufacture of automobiles, or a railroad may spend a portion of its surplus in purchasing a coal property along its line. In these investments, producers extend their business out of their profits and with their own funds. More new wealth is produced by this form of investment than by any other. Every industry is constantly growing from within, as the biologists would say, by intusception, out of the profits of the past, the individual producers are making innumerable ventures of their money into untried fields in enterprises where they alone stand to win or to lose, and where they act from personal knowledge of the opportunity.

A second class of investors there is, which may include the members of the first class, but who are actuated by different motives and who act in a different way. These are also in possession of surplus funds from the employment of which they wish to obtain a profit and they are ready to buy the stock of any corporation which gives them an assurance of satisfactory return. They are in the market for any securities which they consider to be a safe and profitable investment. The members of this class are not, as a rule, in close touch with the industries whose securities they buy. A leather merchant invests in steel, a banker in railroads, a retail dealer in mining stock, not usually because he desires to identify himself with the business in which he invests, so far as to give it his close personal attention and to assist in its management, but solely that he may share in its profits. Included in this class are all investment institutions and managers of trust funds, who take no active part whatever in the numerous enterprises whose securities they hold. The importance of this vicarious interest in industry is steadily increasing, as production is carried on on a larger scale, and as it therefore becomes increasingly difficult for a few men to combine a sufficient amount of capital for the inauguration of a new enterprise, or the development of an enterprise already established. Twenty years ago timber was readily accessible and a few thousand dollars would build a saw mill. A half dozen farmers, by combining their savings, could start in the lumber business. To-day, a well-equipped saw mill may cost $100,000 and added to this must be the expense of perhaps twenty miles of railroad to reach the timber. The assistance of outside capital is becoming every year more essential to the development of any industry or the exploitation of any resource.

The Technical Aspects of Promotion

The proprietors of this outside capital, as we just now observed, know little or nothing about the technical aspects of the industries into which they put their money. They are acquainted with these industries merely as sources of profit. If they can be given satisfactory assurances that profits will be forthcoming from a proposed development, they are willing to invest money to that end. They will not, however, devote themselves to searching out and preparing the propositions into which, when once discovered and prepared, they

are willing to put their money. This attitude of mind of the general investor necessitates the promoter. The promoter, then, is the man who discovers and "assembles" the proposition for the investor, who then, if satisfied with the prospect of profit, provides the fund for its development. The promoter may be, and not infrequently is himself engaged in the industry which he proposes to extend or to develop in some other locality. In this case, his proposals are more favorably regarded by the investor who justly considers that the promoter is well qualified to judge of the merits of the proposition. Mr. John W. Gates, who was associated almost from the beginning with the wire industry of the United States, was a promoter of this class. In projecting the Federal Steel Company and the American Steel and Wire Company, he spoke with the voice of authority. On the other hand, and this is more often the case, the promoter may not be particularly conversant with the practical and technical affairs of the industry. The limitations of practical knowledge may be illustrated by those promoters who make a specialty of certain lines of industry, for example, street railways. A successful street railway promoter will usually have a very keen and trained judgment regarding street railway statistics. He will know the exact percentage which operating expenses ought to bear to total income under given conditions, and of the cost per mile for running cars, and he will be able to analyze with intelligence the statistics of operation and construction, but beyond this he would be unlikely to have any practical knowledge, relying upon the judgment and estimates of reputable engineers to supplement his more general information. Judge William H. Moore, for example, who has within recent years promoted several large steel corporations, is understood to have had but little practical knowledge of the steel industry. The professional promoter, and it is with him that this study is chiefly concerned, in forming his judgment, relies largely upon the trained judgment of experts, civil, mining, mechanical or electrical engineers, lumber viewers, chemists, geologists, metallurgists, machinists. These experts, whose income depends upon their accuracy, give him the necessary technical information about the proposition which he has in mind. They tell him if the coal seam is regular or faulted, if the proposed operation will be self-draining or if pumping machinery must be installed, if the coal is high or low in sulphur and silicon, whether it will make a strong or a weak coke,

or if designed for steam purposes, whether it will be high or low in ash. The professional promoter in the course of his business, and from his association with technical experts, must necessarily accumulate a great store of information, and his ability to make a technical judgment should constantly increase, but if he is in the promoting business, it is next to impossible that he should master all the sciences whose conclusions are put at his service by the experts whom he employs, and whose opinions he relies upon as an aid to convincing the investor.

Financial Aspect of Promotion

Given the technical information, there remains the field where the promoter must rely more largely upon his own ability, the financial aspect of the proposition. Will it pay? In the case of a coal mining proposition, he must determine the price per acre at which the land can be purchased, the rates of freight which will be charged and the price which can be obtained at the different markets. He must consider the labor conditions of the region, the laws of the state regulating the company store, the attitude of the railroads toward an independent enterprise. To spend but a moment upon this last point as illustrating the supreme importance of the promoter's judgment—if his property is located on competing lines, he can look for substantial concessions in rates, but on the other hand, he knows that these favorable rates may flood the markets with low-priced coal in which there is small profit. If he has the facilities of a single line, he must consider whether either the company or its officials are interested in coal properties whose product will compete with his own, in which event in a slack market, his car supply may be suddenly abbreviated. He may also take into account the holdings in this road by another coal road in its bearing upon differentials. All these and a number of other points, the promoter will take into account in forming his judgment as to the probable success of his enterprise; he will be the more careful if he has a record of successful enterprises to strengthen his appeal to the investor.

The Methods of the Promoter

Having formed a favorable judgment, having "discovered" the proposition, the promoter now proceeds to "assemble" it. To this

end, he must either purchase or secure the right to purchase within a fixed time and at a fixed price the property or privilege which he has determined to exploit, whether mine, patent,. timberland or franchise. As a general rule, the method of option is the one usually followed as involving a smaller outlay of cash by the promoter, and implying a smaller loss in case his flotation should be unsuccessful. To continue our illustration: The promoter wishes to purchase 5,000 acres of coal land owned by perhaps fifty farmers. He goes into the district usually armed with a certificate of reputability in the form of a local celebrity at $2.50 per day and expenses paid, and visits these farmers at their homes. He presents his purpose to them, assures them that he will be able to raise the money to develop his proposition, and asks them, for the sake of their mutual interest, and for a nominal consideration in hand paid, to sell him an option to purchase their property at any time within six months, at a price of say, $20 per acre. Various arguments may be employed to influence a general assent to this proposition. The landowners may be shown that the value of the surface soil which will remain in their possession after the transfer of the coal, will be increased by the demands which a coal mining community will make for the produce of their farms. They may be offered the advantage of a railway which the opening of coal mines will bring. The hopelessness of developing their own property may be pointed out to them, and as a last resort the promoter may threaten to "sew them up" by refusing to transport their coal over his roads. By employing these or similar arguments, the promoter persuades the farmers to option or "lease" their land. As far as possible he keeps each owner in ignorance of the terms offered to his neighbors; a general diffusion of such information would cause a general raising of prices. In dealing with the well-to-do and intelligent farmers, he must often pay a high price for the option; the price named in the instrument is also high. The promoter submits to these onerous terms not merely because he wants the land of these hard bargainers who know just how indispensable their coal is to him, but also because he desires to use their names and influence with other owners. These higher prices are recovered in dealing with the more ignorant land owners who are greatly impressed with the representations of the promoter, and also by the fact that their richer neighbors have joined the scheme. It may

even be necessary for the promoter to employ a little corercion in the way of an alliance with the general-store keeper who may hold chattel mortgages and judgment notes against the recalcitrant, powerful arguments when skillfully employed. The promoter has now "assembled" his proposition. The owners have obligated themselves to sell to him at a price until the expiration of six months. He knows exactly how much the land will cost him and he has the land under his control. The next thing is to "float" it, that is to say, to raise the money necessary to develop it. To this end, the promoter forms a corporation whose capitalization, if he is a conservative man, will be based on the probable earning power of the property, say $100 per acre or $500,000 of stock. This stock, to reserve the special details of the flotation to the discussion of the trust, he succeeds in placing at fifty cents on the dollar before the six months of his option have expired, either with investors who wish to hold the stock, or with bankers and financiers who expect to sell at an advance. The investor and the banker purchase the stock because they have confidence in the promoter's judgment, and are therefore influenced by his representations that the proposed undertaking will prove profitable. They may take the trouble to examine the expert reports on the property and will probably visit it under the guidance of experts. Their inquiries, however, are necessarily superficial, and they buy the stock either on the representation of the promoter or of some friend or banking associate in whose judgment they have confidence and who may have gone into the scheme on his own account.

Out of the $250,000 which he realizes by the sale of stock, the promoter pays $100,000 for the land, $75,000 for development and working capital, and either puts the $75,000 remaining into his own pocket or divides it with the financial interests who have assisted him by advances. The foregoing represents a typical promotion. Similar enterprises are constantly being floated throughout the country, not only on mines, but on real estate, manufacturing enterprises, on patents, water power, irrigation, timber and a great variety of resources. The details of each may vary from the form presented, but the essential principles are the same: (1) the securing of a right to purchase an opportunity to make money; (2) the capitalization of that opportunity at a higher figure than the price to be paid the original owner plus the funds required for development;

and (3) the sale of this capitalization to the investor either directly or through the agency of middlemen for a sum of money exceeding the amount necessary to purchase and develop the resource which it is intended to exploit. This difference represents the promoter's profit, the characteristic feature of corporation financiering.

The Profits of Promotion

What now has the promoter done to entitle him to this large profit? He has produced no coal; that is done by the company to which he turns over his options. Neither has he risked an amount of money in any way comparable to the profit which he has made. To obtain fifty options under the circumstances described may not have required an outlay of more than $5,000, and this is an outside figure. Judged by the canons of what is generally considered to be legitimate money making, the promoter has done nothing to entitle him to the $75,000 profit which, out of a flotation of this size, he frequently takes. And yet the profits of the promoter are as legitimate as are the profits of any of the more familiar professions. The promoter is a creator of value. He brings into existence a means of producing wealth which did not before exist. By combining the control of a number of separate pieces of coal property into a fully equipped coal mining enterprise, he is able to offer to the investor an opportunity to earn say 12 per cent on his money; in other words, to sell to the investor $500,000 worth of stock which can be depended on to pay dividends of 6 per cent, for $250,000. Without this combination, in the hands of individual owners, without transportation facilities, and without modern equipment, the value of this coal, based on its earning power from the small openings which produce for the local trade, did not exceed $20 per acre. Combined under one ownership, connected with a trunk line railroad, and equipped for large operations, a value of $100 per acre is not excessive. This increase in value of $80 per acre is the result of the investment of $35 per acre—$20 in the purchase of the coal and $15 in its development. In order to obtain the money necessary to purchase and develop his proposition, the promoter has been obliged to sell the opportunity which he controls at one-half its real value, *i. e.*, at $50 per acre. Deducting the $35 which must be spent to put the coal on the market, there remains $15 per acre, or in all, $75,000 as the promoter's profit, a profit differing in no essential

feature from the gains of the manufacturer who contracts ahead for his pig iron and takes advantage of a rise in the nail or wire market.

The Service of the Promoter

But it may be objected, why should the promoter be allowed to make this large profit? Why should it not be divided between the farmer who owns the land and the investor who furnishes the money? What is the justification for the promoter's profit? The answer to these questions lies in the nature of the transaction. The promoter is entitled to his profit because he has optioned coal at the value which its owners placed upon it, and has sold his rights to another set of persons who place upon these rights a much higher value. The farmers, except in exceptional instances, could not even organize their own proposition, much less finance it. Mutual jealousies, local feuds, and overmuch mutual information about the character and financial standing of local individuals who might undertake this work would interfere with any general agreement. It would be found, for example, next to impossible to agree upon the proper price for different pieces of coal. Farmer A, whose land lies near the creek would insist upon a higher value for his property than Farmer B, whose coal is less accessible, while B, on his part, might cite, as a reason for disputing the justice of A's claim, the fact that his coal had been opened in several places while nobody knew that A had any coal on his property. Farmer C, who owned land across the right of way of the proposed railroad, and who, therefore, considered his co-operation indispensable, might insist upon a price of $150 per acre, which would probably disgruntle his less favored and jealous neighbors and so defeat the scheme. The Brown family might refuse to go into any agreement with the Jones family, with whom one of the chiefs of the Brown clan has had a law suit of some years' standing. Any one of a number of similar causes which might be cited would be sufficient to prevent the concentration of control of these separate properties, which are of small value unless combined. Some one interest acting exclusively for its own advantage and dealing independently with each owner, is essential to the assembling of such a proposition. This interest may be local, and, as already noted, by means of local alliances, the task of the promoter is made easier, but in most cases, the successful coal promoter is the outsider who can pose as the man of wealth and con-

nection, and who can reap his harvest of options during the pleasant weather of a first impression. It is the general experience of promoters that an outsider of imposing personality, pleasing address and experience in handling men, has usually much greater success in securing options than even a local squire or other celebrity whose standing in the community is of the best, but who is too well known to be allowed by his neighbors to make any money out of their property.

Even if the farmers succeeded in getting their proposition together in the control of a selected committee or individual, they would have great difficulty in securing a financial connection. They would have to provide for expert reports on the property, and then to open negotiations with some financial interest with whom none of their members would probably be personally acquainted. After securing an introduction, they would present their proposition, probably in a lame and halting manner, which would not show that they possessed a comprehensive knowledge of the importance of the property in question to the general coal market. If the banker to whom they would naturally apply for funds, since they would have no connection with the investing public, was sufficiently interested to examine the proposition and to determine its value, he might take one of two ways to further his own advantage. He could either prolong the negotiations until the local contingent lost heart and withdrew, trusting to his own ability to obtain the options for himself, or he could compel the representatives of the owners co-operating to accept a price not greatly exceeding the face of their options, in which event, the financier would be the promoter one stage removed, and acting by deputy. It is evident, therefore, that the promoter's profits on such propositions cannot be saved for the original owners of the coal. It is the same with any other proposition. The proprietor of undeveloped opportunity is seldom in position to bargain to advantage for its sale. His best course is to put his property in the control of some promoter at a fixed price and for a definite time, contenting himself with effecting a sale not at a price which he thinks the property is worth, but the price which will represent a fair return on his investment of brains or money. Any attempt on his part to promote his own scheme will probably end in failure. The failure of inventors to make more out of the sale of their patents is probably due more than to any other cause, to the fact

that they insist upon an excessive interest for themselves and are unwilling to offer sufficient inducements to those who might otherwise be disposed to promote their schemes.

As for the investor participating in the promoter's profits, this, in the nature of the case, is impossible. The investor is looking for a security which will produce as large an income as is consistent with the safety of his principal. As shown above, he is not likely to concern himself with the active management of those industries into which he puts his money. How much less likely is he therefore, to abandon his regular business or profession to roam about the country in search of resources to develop. The investor of necessity assumes a receptive attitude. He is the customer to whom the promoter and the financier offer their wares. He buys on his opinion not so much of the merits of the proposition as of the reputation of those who offer it for sale. Even if the promoter should be compelled to take a profit of only $10,000 instead of $75,000 and should be required by law to leave $75,000 additional in the property, the investor would get no benefit. Suppose that this should be done and note the consequences to the investor. We must assume that the enterprise has been fully equipped with machinery and working capital, and with experienced and responsible promoters; in this class of propositions this assumption would be generally correct. We must assume, that is to say, that out of our 5,000 acres of coal land, a well-managed company is able to earn one year with another, $50,000 per year, 10 per cent on the capital stock, by an investment of $175,000. The law, however, compels the promoter to invest $65,000 more for the benefit of the company. This might be done in enlarging the scope of the enterprise, taking in more land and working a second shaft. The result of these enlarged operations, since the same equipment could handle a larger output, might be a total annual profit of perhaps $90,000 per year on the same capitalization as before, viz, $500,000, or 18 per cent. If the investor would pay—allowing the banker his profit—70 for a 10 per cent security which the profit of $50,000 represented, he will pay 126 for an 18 per cent security, represented by the larger profit of $70,000 due to the sequestration for the benefit of the company of the promoter's surplus. On the first investment, allowing the promoter to take what remains after the proposition is fully equipped, the investor receives an income of 14.2 per cent, and on the second

investment, he receives the same amount, for the price which he will pay for the stock rises with the rate of dividend which it yields. The investor therefore could not profit by the curtailment of the profits of the promoter. The only result of such action would be that the net earnings and dividends of the company would be increased. The investor, however, would receive the same rate of income from investing $1,000 in a 10 per cent stock at 70, as he would receive from $1,000 invested in an 18 per cent stock at 126. It is true that the community might be the gainer because a larger amount of coal might be produced from the larger investment. This conclusion, however, rests upon two assumptions: First, that the original plans of the promoter were not large enough, since he could probably have capitalized his enterprise at $900,000 instead of $500,000 in case he considered that market and mining conditions warranted the larger output of coal and, that the promoter will make an ineffective and wasteful use of the $75,000 profit which he takes out of the enterprise and will not employ these funds in furthering new enterprises to which he may turn his attention. Neither of these assumptions is apparently well grounded. The promoter has, it is safe to say, if he is a conservative and intelligent man, provided for as large a production as is warranted by the conditions surrounding the enterprise, and if his profits appear large, they are usually turned back into new ventures whose success will increase the wealth of the community. We must conclude, therefore, that the promoter performs an indispensable function in the community by discovering, formulating and assembling the business propositions by whose development the wealth of society is increased. He acts as the middleman or intermediary between the man with money to invest in securities and the man with undeveloped property to sell for money. In the present scheme of production, the resource and the money are useless apart. Let them be brought together and wealth is the result. In most cases, the unassisted coincidence of investment funds with investment opportunities is wholly fortuitous and uncertain. The investor and the land or patent or mine owner have few things in common. Left to themselves they would never meet. But the promoter brings these antithetical elements together; in this way utilities are created which did not before exist, and which are none the less a social gain because most of the advantage is taken over by the promoter and the financier.

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